

**DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 97-0462
SALES/USE TAX
For The Tax Periods: 1991 through 1995**

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ISSUES

I. Use Tax –Labels

Authority: IC 6-2.5-3-2, IC 6-2.5-5-6, 45 IAC 2.2-5-14, 45 IAC 2.2-5-12.

The Taxpayer protests the Department's assessment of use tax on labels.

II. Use Tax – Sampling Method

Authority: IC 6-8.1-4-2, IC 6-8.1-4-1, IC 6-8.1-5-1.

The Taxpayer protests the Department's method of sampling for its assessment of use tax.

STATEMENT OF FACTS

Taxpayer was audited for sales/use tax for the periods of 1991 through 1995. Taxpayer manufactures zinc die cast electrical connectors. Although some parts are completed at the out-of-state plant, most of the production parts are transported to the Indiana plant where labor intensive assembly and packaging operations are performed. The castings move through chamfer, broach, assembly, and thread operations of the Bodine machines and proceed to hand assembly before storage in the finished goods storage area. Packaging operations later bulk-pack the parts into cartons and affix labels bearing customers' names and logos. More facts supplied as necessary.

I. Use Tax: Labels

"An excise tax, known as the use tax, is imposed on the storage, use, or consumption of tangible personal property in Indiana." IC 6-2.5-3-2. During the audit, the auditor assessed use tax on the labels placed on the cartons.

Taxpayer argues that the labels are part of the packaging process which is included in the production process, and are therefore exempt from taxation. They go on to state that the labels are not shipping labels, rather, they are customized labels with the reseller's name, a description of the parts contained within the package and other pertinent data.

IC 6-2.5-5-6 states:

Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for incorporation as a material part of other tangible personal property which the purchaser manufactures, assembles, refines, or processes for sale in his business....

More specifically, 45 IAC 2.2-5-14 states in relevant part:

- (d) The purchase of tangible personal property which is to be incorporated by the purchaser as a material or an integral part is exempt from tax. "Incorporated as a material or an integral part into tangible personal property for sale by such purchaser" means:
 - (1) That the material must be physically incorporated into and become a component of the finished product;
 - (2) The material must constitute a material or an integral part of the finished product; and
 - (3) The tangible personal property must be produced for sale by the purchaser.
- (e) Application of the general rule.
 - (1) Incorporation into the finished product. The material must be physically incorporated into and become a component part of the finished product.
 - (2) Integral or material part. The material must constitute a material or integral part of the finished product.
 - (3) The finished product must be produced for sale by the purchaser.

First, Taxpayer incorrectly states that the labels are consumed in the production process. 45 IAC 2.2-5-12(g) defines the terms "consumed" as; "the dissipation or expenditure by combustion, use, or application...." Consequently, the exemption provided by 45 IAC 2.2-5-12(c) for purchases of materials to be directly consumed in the production process does not apply.

Second, Taxpayer also contends that the labels are part of the product being resold pursuant to IC 6-2.5-5-6. Taxpayer states that the customized labels are clearly part of the product being sold and without the customer's name and specification of the box, the items could not be resold. However, the finished goods are stored before packaging. Although the labels are customized, Taxpayer sells the fungible goods to the retailer, who in turn, sell the parts to the individual customer. Pursuant to IC 6-8.1-5-1, "[t]he burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." Here, Taxpayer has not demonstrated that the labels are incorporated as a material or integral part of the completed product pursuant to IC 6-2.5-5-6.

FINDING

The Taxpayer's protest is denied.

II. Use Tax: Sampling Method

DISCUSSION

Taxpayer protests the auditor's sampling method. The auditor made an adjustment for expenses by examining all the invoices for a particular month and calculating the amount that sales/use tax was not paid for each account examined. The auditor then divided that amount by the total of all invoices of each account for the sample month to determine the error percentage of each account. The auditor then applied that percentage for each selected account to the total for each account in each year included in the audit.

Taxpayer believes the month selected is not representative of the audit period as a whole. In addition, they state the month selected was at the end of the audit period and contend that the earlier years cannot be represented by one month several years later.

The Department may examine the books, records or other data bearing on the correctness of the returns. IC 6-8.1-4-2. Also, pursuant to IC 6-8.1-4-1(b)(2), the audit division may "annually audit a statistical sampling of the returns filed for the listed taxes that are not administered by the special tax division." The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made". IC 6-8.1-5-1.

Taxpayer has not provided any documentation to support their claim that the period selected was exceptional or provided any reasoning why a later period cannot be selected. The Department finds that the auditor acted within her authority to provide a statistical sampling for the audit periods in question.

FINDING

The Taxpayer's protest is denied.